

Non-Interest Capital Market Instruments as Alternative Liquidity Management Tools for Pension Assets

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October 2021





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Global Trend

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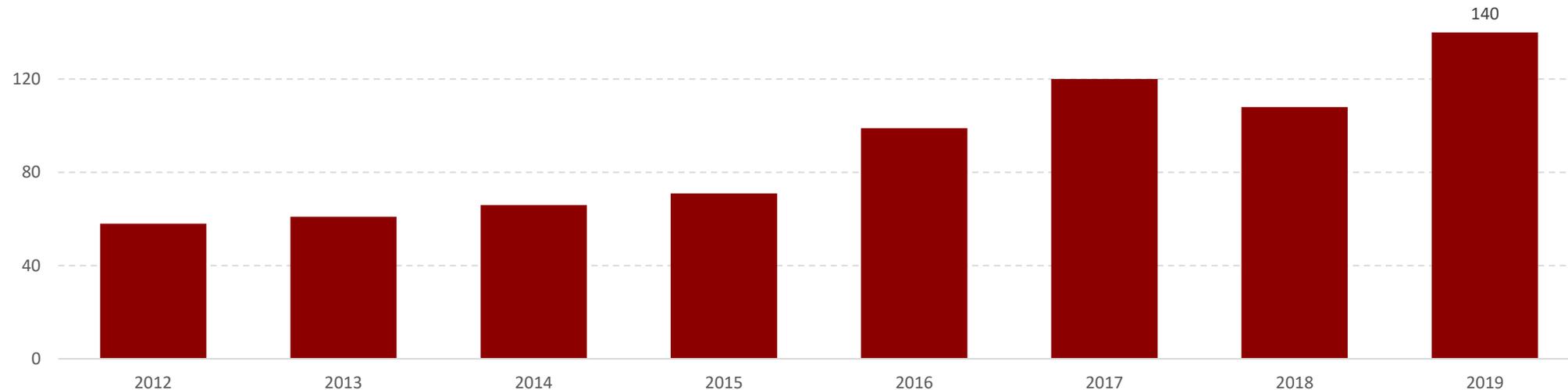
Investment
Instruments

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Growth Areas

- According to the Islamic Finance Development Indicator (IFDI) 2020, the Islamic finance industry saw double-digit growth of 14% in 2019 to a total US\$2.88 trillion in assets.
- The growth in global Islamic finance industry assets was partly due to sukuk issuances in the GCC and Southeast Asia, including Green and SRI (socially responsible investment) sukuk.
- Islamic pensions are mostly categorized under investment funds, and the total assets under management (AuM) for Shariah-compliant investment funds saw their highest growth in the last decade, rising 30% to \$140 billion, from US\$108 billion in 2018. In all, 127 funds were launched in 2019, including Shariah-compliant mutual funds, pension funds, insurance funds, and exchange-traded funds (ETFs).
- IFDI reports that there are over 80 non-interest pension funds in its survey in 2019 particularly in the Middle East and South East Asia.

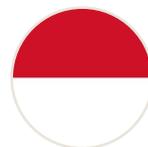
Islamic Funds Value Outstanding Growth 2012 - 2019 (US\$ Billion)



Preliminary data for 2020 indicated that pension funds held over US\$35 trillion in assets worldwide at the end of 2020, exceeding 2019 levels despite the COVID-19 pandemic, according to Pension Funds in Figures (culled from IFN). There is still significant growth expected in total pension assets with adoption of Islamic pensions in countries such as Saudi Arabia, Turkey and Pakistan.



Pakistan



Indonesia



Turkey



Malaysia

Update

Pension Funds make up 2% of Pakistan's non-banking financial industry. According to a report by the Pakistan Credit Rating Agency, the country recorded PKR34 billion (US\$214.57 million) in assets as at November 2020, out of which Shariah compliant pension funds recorded PKR22 billion (US\$138.84 million) in total assets for the same period.

The Republic of Indonesia, home to at least two companies offering Islamic retirement schemes. According to the Financial Services Authority, the country's pension industry recorded US\$21.72 billion in total assets, an increase from the US\$20.11 billion recorded in 2019.

Voluntary Islamic pension funds in Turkey, known as participation retirement schemes invest in property and commodity bonds or funds, Shariah-compliant equities, government bonds and other permissible vehicles

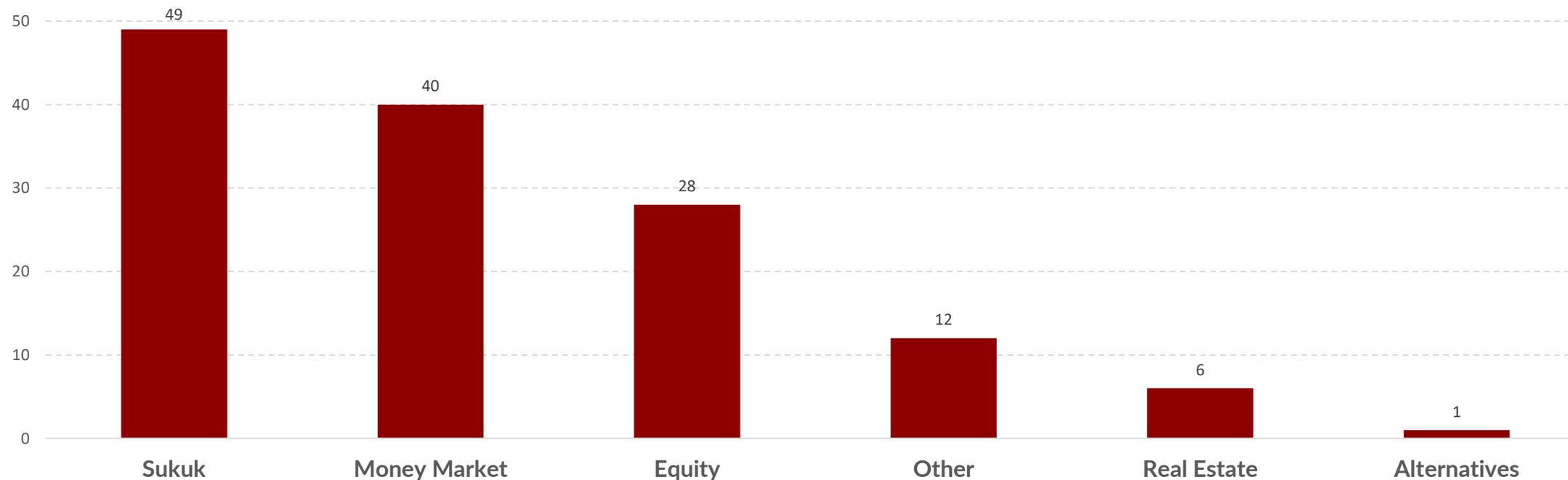
Malaysia is one of the few countries that have pension funds investing in Islamic investments, one of which is the Employees Provident Fund (EPF) which recorded a 7.9% increase to US\$239.98 billion in total investment assets for 2020, compared with US\$222.36 billion recorded in 2019.

The state-backed Shariah-compliant pension fund was introduced in 2016 as part of Malaysia's state pension plan Employees Provident Fund

Islamic pension schemes are also growing in non-muslim majority countries such as the United Kingdom and Australia: UK - the Government's first Child Trust Fund (CTF), Islamic Pension Trust, Nest Sharia Fund under the (National Employment Savings Trust) and the HSBC Life Amanah Pension Fund, Australia - Islamic pensions/superannuation funds provided by Crescent Wealth, First Guardian and Hejaz Financial Services.

- According to the Islamic Finance Development Report 2020, fixed income instruments such as Sukuk and Money market investments accounted for 64% of investments in Islamic funds (including pensions). The traditional asset types (money market, bonds and equities) accounted for 83%.
- This investment focus is a reflection of investors/contributors' appetite. The investible assets for the investment of pension funds in the domestic market would likely have a similar focus.

Islamic Funds Outstanding Value by Type 2019 (US\$ Billion)

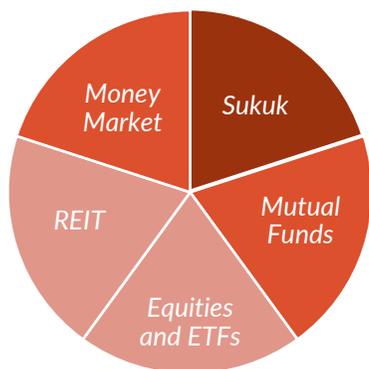




- The growth and development of the Nigerian Non-interest Capital Market has been deliberate.
- The current state of the market is not the product of speculation or random happenings, but rather it is the result of the coordinated efforts of regulators, industry operators, international institutions and government agencies. Special credit is due to the Securities and Exchange Commission for development and implementation of the **Non-interest Capital Market Masterplan**.
- The goal of our Non-interest Capital market is to create a sustainable and vibrant system that is inclusive, socially impactful and places equal emphasis on ethics and profits, such that neither of these fundamentals to economic progress are compromised.
- We have long considered the full adoption of Non-interest Finance by the Pension Industry as pivotal to its development.
- This is because the pension industry not only controls the single largest asset pool, but more importantly, pension participation has the potential to cover a wide demographic of the country, the investments are well regulated and structured, and the funds are managed by professional institutions whose diligence will only further promote financial stability.
- The industry is also supported by The Non-interest Financial Institutions Association of Nigeria (NIFIAN)

- While the size of investible assets in the Non-interest market might currently pale in comparison to Pension Assets, the key factor hidden within the numbers is the pace of growth and breadth of adoption of Non-interest finance over the last 3 years.
- The investment landscape has witnessed increased participation of traditional operators alongside, new entrants and the expansion of existing players.

Available investments within the market have expanded to include all traditional asset types, while the number of operators (and participants) have also increased.



5 Banking

There are currently three full-fledged non-interest banks and two conventional banks operating non-interest windows

4 Insurance

Takaful (non-interest insurance) firms operating in Nigeria are four at the moment. NAICOM indicates that some more are seeking licensing



Sukuk

Sukuk issuance by the DMO in excess of N362 billion has set the stage for further issuances by other entities including corporates

Asset Management

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There are 10 SEC-registered mutual funds, up from 6 a year ago.

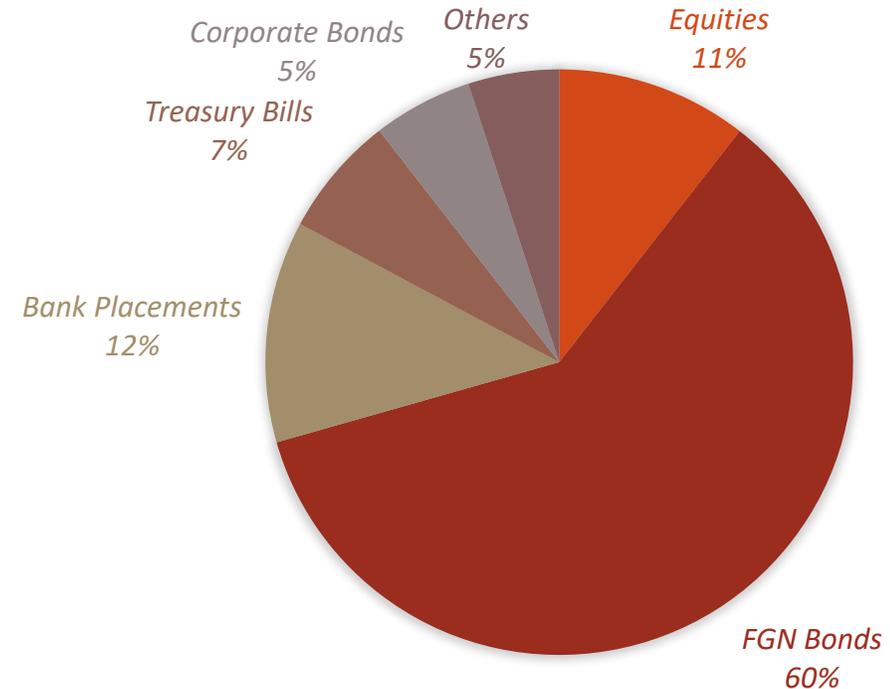
Others

Other market participants including multilateral organizations have tapped the market

The regulatory framework of the National Pension Commission (PenCom) allows the investment of pension assets in a range of instruments;

- I. Government Sukuk, (including Islamic Treasury Bills and Eurobonds (including Sukuk) issued by FGN, CBN or FGN Agencies and Infrastructure Sukuk, backed by FGN/CBN guarantee)
- II. Corporate Sukuk (including ABS, MBS, GDNs, Eurobonds (including Sukuk) & Infrastructure Sukuk)
- III. Supranational Sukuk
- IV. Shariah compliant Money Market instruments
- V. Shariah compliant ordinary shares (including GDRs)
- VI. Shariah compliant Infrastructure Funds
- VII. Shariah compliant Private Equity Funds
- VIII. Shariah compliant Open/Closed/Hybrid Funds

Using the current Industry structure as an indicator, pension investment in non-interest instruments will likely reflect the existing asset allocation of conventional pension funds once the market develops.



- Breakdown of Assets under Pension Fund II as at March 2021 (Pencom)

- The NGX Lotus Islamic Index has captured equity performance data for more than seven (7) years. It currently provides investment exposure to six sectors on the exchange. The Index market cap is 59% of NGX All Share Index market capitalization, which demonstrates depth for equity investing. The Lotus Halal Exchange Traded Fund, which is reconstituted and rebalanced bi-annually provides exposure to the index, while allowing for portfolio management strategies (core-satellite). We expect equity issuances by Non-interest finance institutions to further deepen this space in the near term.

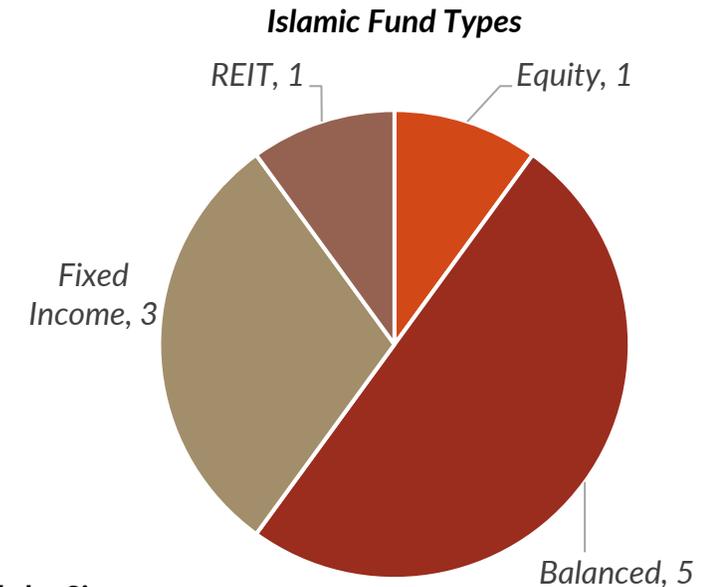


- With over 100 registered asset managers in Nigeria, there is significant scope for growth as more fund managers develop non-interest alternatives as part of market expansion strategy. Mutual funds can support liquidity management for pension funds through prompt investment selection with the benefit of professional management and a regulated framework.

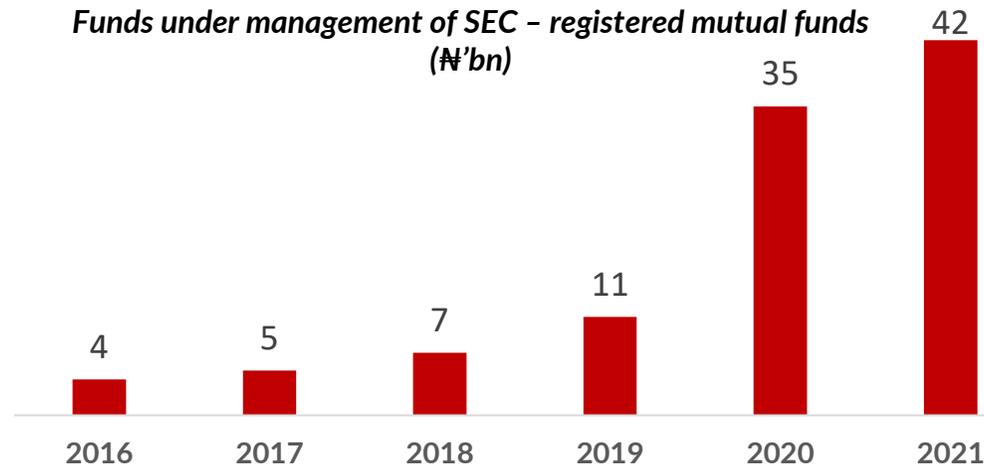


No. of Non-interest Mutual Funds
10 non-interest mutual funds

Investment
Over ₦40 billion assets under management in public funds



Funds under management of SEC – registered mutual funds (₦'bn)



Top 5 Non-interest Mutual Funds by Size

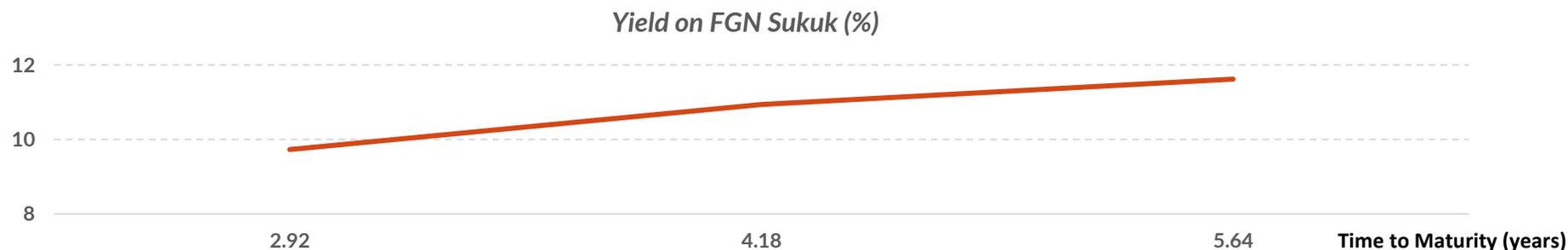
Mutual Fund	Asset Allocation*	Fund Size* (₦)
Lotus Halal Fixed Income Fund	Sukuk, Fixed Income Investments	14.49 billion
Stanbic Shariah Fixed Income Fund	Sukuk, Fixed Income Investments	8.15 billion
FBN Halal Fund	Sukuk, Fixed Term Investments	4.94 billion
Lotus Halal Investment Fund	Equity, Fixed Income Investments	2.92 billion
United Capital Sukuk Fund	Sukuk, Fixed Term Investments	1.83 billion

Source: www.sec.gov.ng as at October 15, 2021 and Lotus Research (Table figures are ex REIT)

- Placements in Non-interest banks are an increasingly important option for liquidity management. These are usually on the basis of Mudarabah contracts that are arranged to approximate money market investments. An investor invests in the NIB's pool of assets and shares in the returns generated from the assets.
- The increase in the number of players and the adoption of financial technology are critical growth drivers. Non-interest banks are showing signs of marked financial improvement and capacity for asset growth. Notably, Jaiz Bank obtained an investment grade rating from Agosto & Co.
- The bank was also assigned an investment grade rating by the Islamic International Rating Agency (IIRA) in 2020
- The credit migration history of an existing non-interest bank is vital to institutional assessment and investment appraisal. The breadth of players also provides opportunities for comparative analysis and improved decision making.

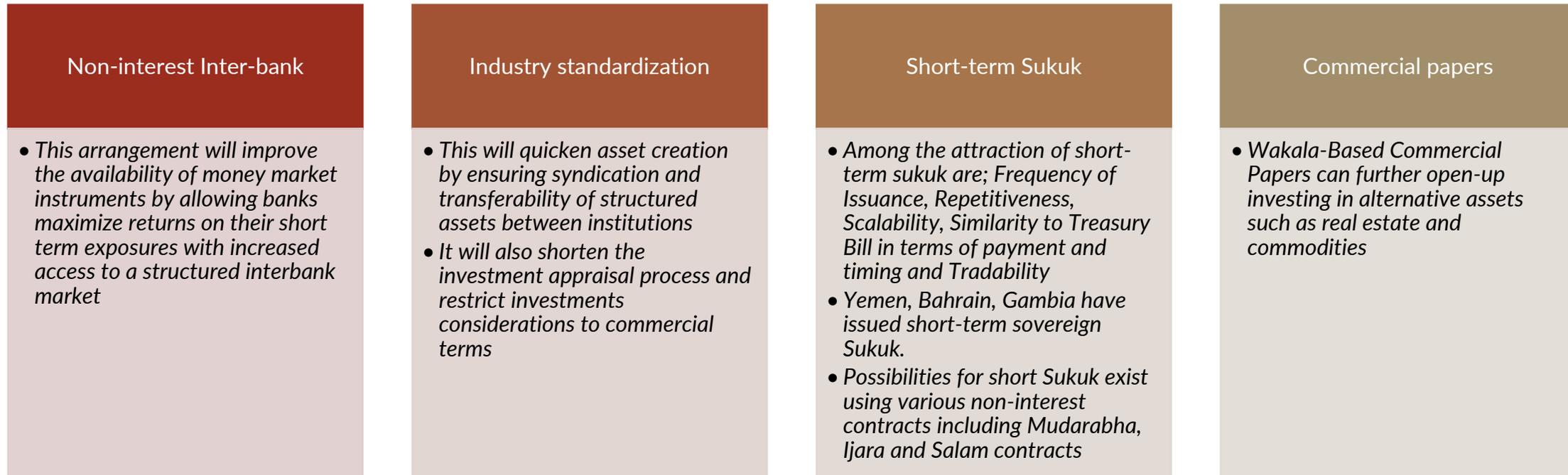


- Through consecutive Sukuk issuances, the market is deepening. The issuances have served to create a yield curve for Sukuk instruments, Frequent Sukuk traders can analyze the average Sukuk trading spreads, key investors and trading patterns. This is another critical development for liquidity management which assists with the creation of business models for a pension Sukuk portfolio.

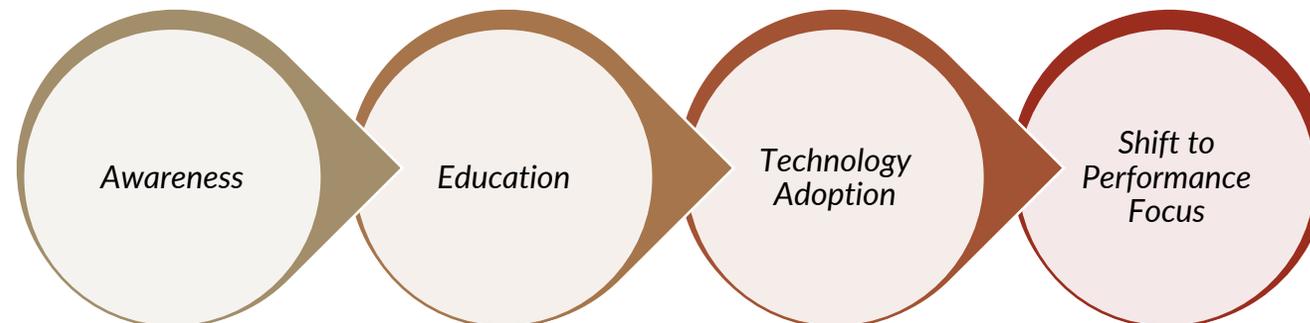


- In addition to the 3 outstanding Sovereign issuances, the DMO is in the processing of issuing a fourth Sukuk. Other issuances include the Family Homes Sukuk and various private Sukuk which have created more familiarity in the market on Sukuk structures.
- Further Sukuk issuance growth would be driven by;
 - Capital enhancement of non-interest banks and takaful providers
 - Corporate sukuk issuance for equipment and projects
 - Affordable housing projects by corporate and government-linked entities
 - Green project financing and renewable energy by corporates
 - Road and other infrastructure by sovereign and sub-national entities

- With the concerted efforts of industry operators, there is renewed focus on enhancing liquidity management through non-interest products.



These efforts need to be supported by:





Lotus Capital
HALAL INVESTMENTS